BCPSS Financial Recovery Overview

Introduction

This document encapsulates the specific budgetary measures that have been suggested in recent weeks and months to address the Baltimore City Public School System's (BCPSS) immediate cash flow needs and its threatening cumulative budget deficit. As was originally explained by Senator Neall, the development, implementation, and public communication of a thoughtful plan that effectively illustrated that BCPSS was on a path to address and eliminate its cumulative deficit would restore the System's credibility to seek and receive assistance from the State of Maryland or private lending institutions to address its short-term cash flow needs.

The Current State of Affairs

The BCPSS's January 13, 2004 presentation entitled *Cost Containment Phases I, II, and III* (authored and repeatedly delivered by Senator Neall) recounted the System's FY04 financial state of affairs:

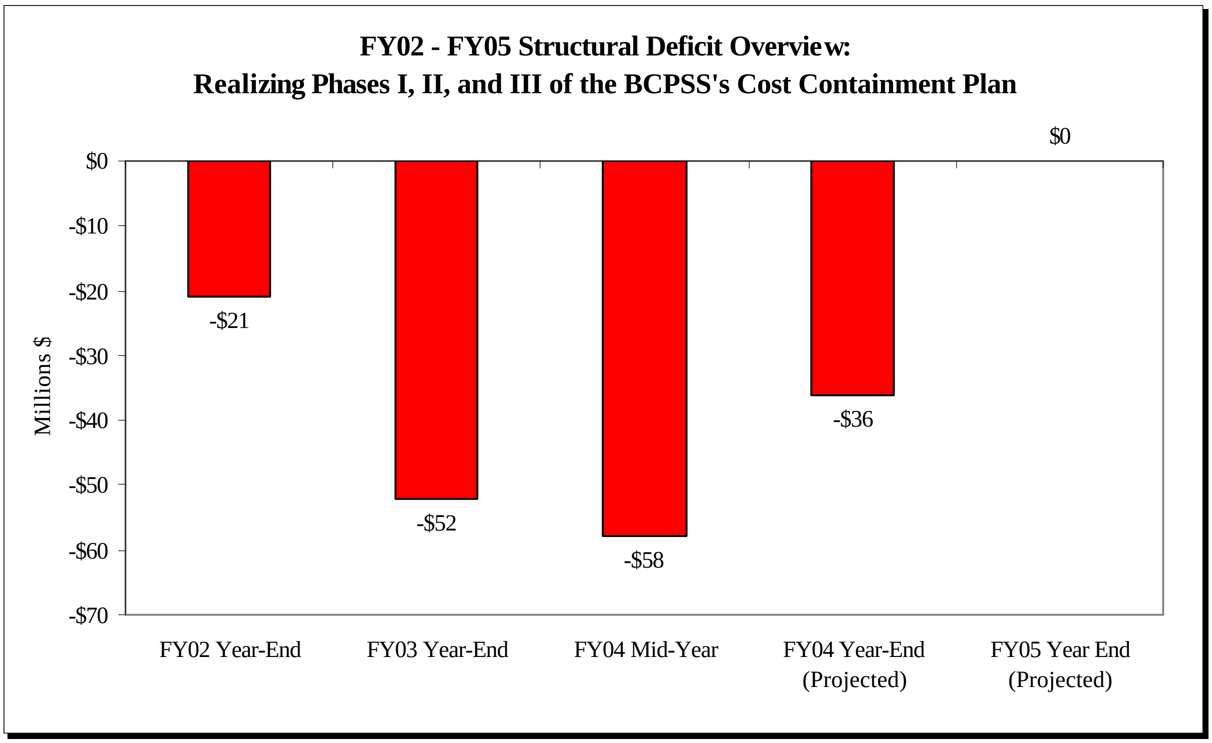
Fiscal Year End 2002:	-$21 million deficit
Fiscal Year End 2003:	-$31 million deficit
Cumulative FY02 – FY03 Deficit:	**-$52 million**
Mid Fiscal Year 2004:	-$6 million in bad accounts receivables
Revised Cumulative Deficit as of Mid Fiscal Year 2004:	**-$58 million**

The risk that the BCPSS's cumulative deficit situation could worsen became further exasperated by unsustainable spending patterns during the first months of fiscal year 2004. This necessitated Phases I and II of the cost containment plan which encompassed the following measures:

- Eliminating non-essential temporary employees
- Eliminating surplus teachers and administrators
- Reducing central office staff
- Terminating contracts of retired teachers
- Eliminating surplus middle and high school teachers/administrators, based on mid-year enrollment declines
- Eliminating and/or reducing contracts and non-salaried expenses
- Reducing more central office staff
- Reducing more temporary employees

The measures of Phase I and II of the cost containment plan were hoped to result in approximately $15 million in savings during the second half of fiscal year 2004. The full year annualized savings—to be realized beginning in fiscal year 2005—reach $30 million. Part of the usefulness of the loan and advances being considered by the State, City, and Abell Foundation is that the availability of these funds affords the BCPSS the time to realize the full year impacts of the already undertaken cost containment measures.

Despite the gains recorded in Phases I and II of the cost containment plan, the BCPSS and Senator Neall believed that more progress towards reducing the cumulative deficit needed to be achieved. Phase III of the cost containment plan called for achieving another $16 million in reductions during fiscal year 2004. ***If*** the aim of Phase III were achieved, the BCPSS would enter fiscal year 2005 with just a $36 million cumulative deficit—meaning that the BCPSS would have been on pace to end the current fiscal (2004) year with a $22 million surplus.

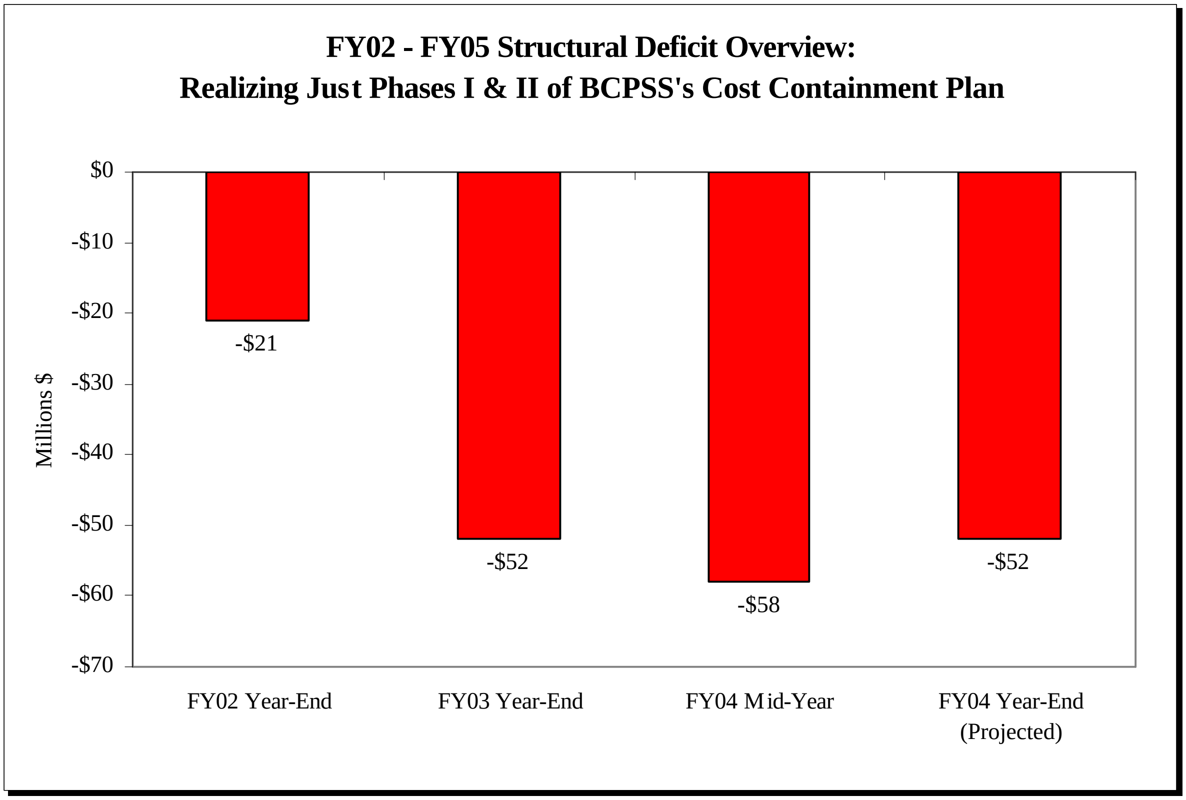


Despite the daunting prospects of entering fiscal year 2005 with a $36 million cumulative deficit, it must be remembered that the annualized impacts of the measures undertaken as part of Phase I and II of the cost containment plan would have put BCPSS close to eliminating the still remaining cumulative deficit by the end of fiscal year 2005.

As followers of the current situation well know, the $16 million in savings specified in Phase III of BCPSS's cost containment plan have not yet materialized. Initially, concessions suggested by BCPSS to its unionized workforce were rejected. Subsequently, reduced labor concessions—enabled by an $8 million loan from the City of Baltimore's "Rainy Day Fund"—were also reduced. Finally, even with the inclusion of an $8 million loan package from the Abell

Foundation that would have effectively replaced the impact of the requested labor concessions, the situation seems to have further deteriorated.[1]

Even without realizing the gains contemplated in Phase III of the cost containment plan, BCPSS would be on pace to achieve progress towards eliminating its structural deficit in the current fiscal year.

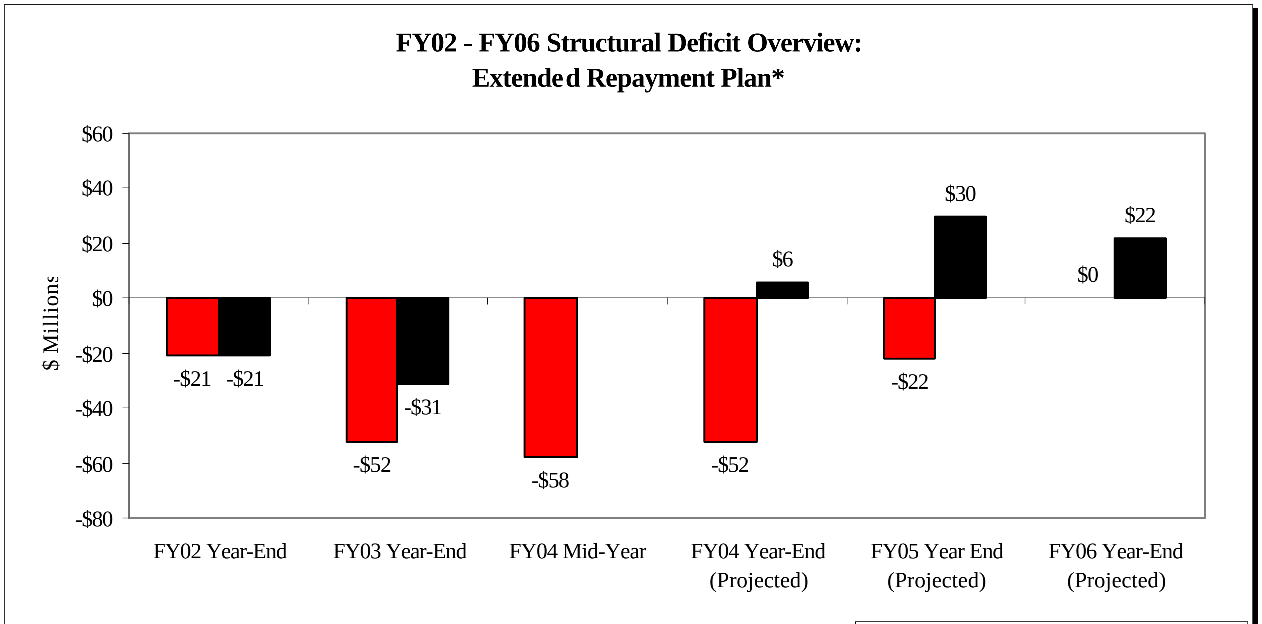


<u>The Pace of Recovery</u>

A paramount issue in any discussion of how the BCPSS returns to solvency is the timeframe for which it emerges from this crisis. Barring the infusion of new revenues that do not require repayment, there remains only four months of the current fiscal year and all of fiscal year 2005 to reverse the situation—a daunting task that will necessarily have a pronounced negative impact on the classroom.

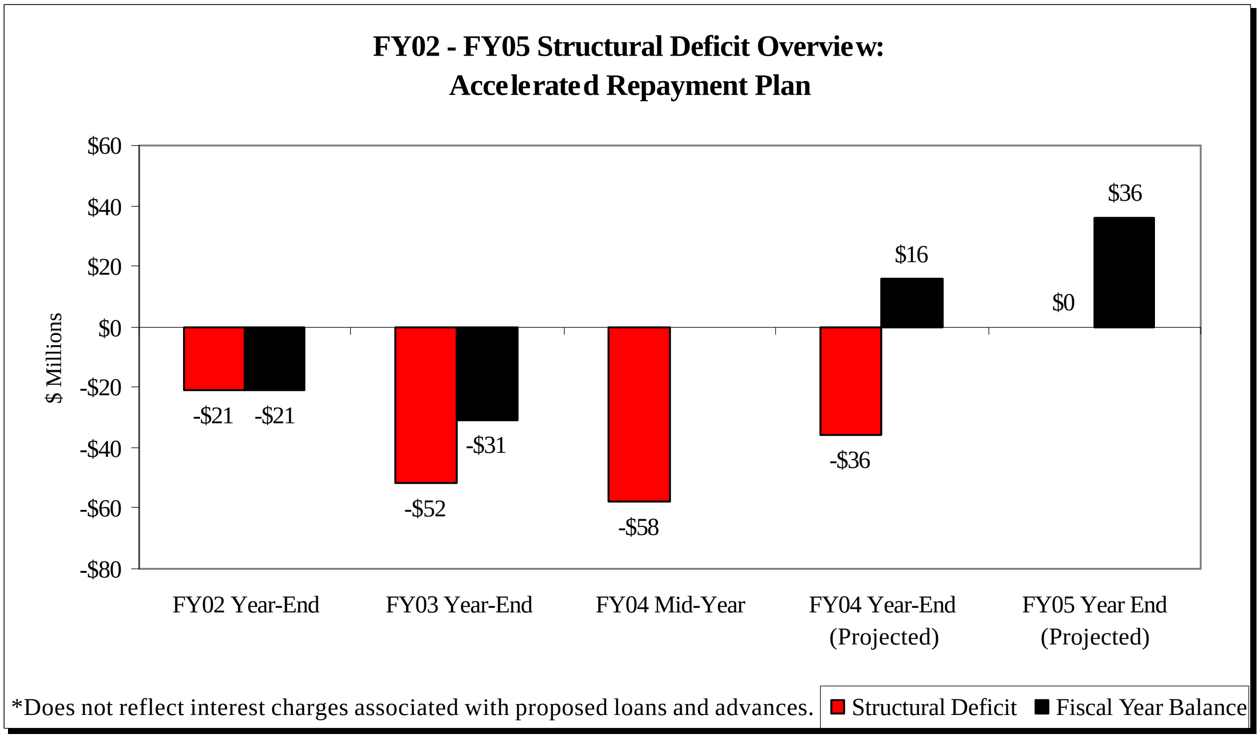
[1] Of note, Senator Neall has questioned the utility of the $16 million loan package offered by the City of Baltimore and the Abell Foundation. While the difference in the comparative value of a realized $16 million savings achieved via labor concessions that do not need to be repaid versus a $16 million loan package at a nominal interest rate is not in dispute, the loan package was intended to buy the BCPSS time to realize the full benefit of its already undertaken cost containment measures and to temporarily put off further measures until after the conclusion of the current school year so to minimize disruptions for teachers, parents, and, most importantly, Baltimore City's public school students.

The intrinsic value of all the suggested packages of assistance (State, City, and Abell) is the time that it affords the already enacted and the currently contemplated cost savings, cost avoidance, and accountability measures to take hold. For example, if one considers the following scenario illustrated in the next chart, even with the failure to realize the impact of Phase III of the cost containment during fiscal year 2004, BCPSS will still make progress on deficit reduction during the current fiscal year. This progress, when combined with just the fully realized impacts of Phases I and II of the cost containment plan during fiscal year 2005, would leave BSPSS on pace to close fiscal year 2005 with just a $22 million cumulative deficit.



*Does not reflect interest charges associated with proposed loans and advances.

Conceivably, this progress could be achieved without initiating further measures, but it fails to take into account the probably impact of other cost drivers (e.g., increased operational costs, employee health benefit costs, interest charges associated with State, City, or Abell assistance, etc.) or a State-mandated acceleration of the BCPSS's recovery (as illustrated in the next chart based on realizing during fiscal year 2004 the gains targeted in Phase III of the cost containment plan). These considerable and still outstanding risks would need to be addressed.



Options for the Future

The February 20th plan submitted by BCPSS to Secretary DiPaula and Mayor O'Malley's February 25th letter to Governor Ehrlich summarized a number of options available to retire the cumulative deficit under either an extended or accelerated repayment plan and are categorized as follows:

Options	Estimated Impact	Savings Type
Accelerated existing financial settlements	$33.6 million	Revenue Enhancement
End of School Year Attrition	$15 million	Cost Savings
Structured Early Retirement Plan	TBD	Cost Savings
Rebidding 60 transportation contracts and achieving a 10 percent savings	$2 million	Cost Savings
Centralizing the 04/05 school bell system	$2 million	Cost Savings
Further administrative staff reductions & scheduling adjustments	$2 million	Cost Savings
Further staff layoffs	As necessary	Cost Savings
Eliminating summer school	$12 million	Cost Avoidance

These and other options that might be suggested by stakeholders must be realized through careful monitoring by the strengthened governance mechanism being actively discussed by the State of Maryland, City of Baltimore, and legislative leadership.